

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

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Person To Contact:

Telephone Number:

Refer Reply To:

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Date:

September 29, 2006

TY:

Taxpayer =

Country A =

Date a =

Date b =

Date c =

Date d =

Date e =

Date f =

Year A =

Year B =

Year C =

Year D =

Sub A =

Sub B =

Sub C =

Sub D =

Sub E =

Amount a =

Amount b =

Amount c =

Amount d =

Amount e =

Amount f =

Amount g =

Amount h =

Amount i =

Amount j =

Amount k =

Amount l =

Period A =

Period B =

Period C =

Period D =

Dear :

This is in response to your letter dated Date a in which you request a ruling that Taxpayer may use a net operating loss (NOL) inherited from a subsidiary as a deduction in computing its U.S. effectively connected income for the Year A taxable year.

The ruling contained in this letter is predicated upon facts and representations submitted by the Taxpayer and accompanied by a penalties of perjury statement executed by the appropriate party. This office has not verified any of the material submitted in support of the request for a ruling. Verification of factual information, representations and other data may be required as part of the audit process. Taxpayer has represented the facts described below.

FACTS:

Taxpayer is a life insurance company resident in Country A that provides insurance, asset management, and investment advisory services outside the United States. Taxpayer is a partner in several domestic partnerships. Since Year B, Taxpayer represents it has been indirectly engaged in a trade or business within the United States through the activities of its U.S. partnerships. Taxpayer files a Form 1120-F U.S. Income Tax Return of a Foreign Corporation to report its share of effectively connected income from the partnerships. On Date b, Taxpayer created a wholly-owned domestic subsidiary, Sub A. Sub A invested in U.S. real estate through various partnerships and

loaned money to the partnerships. In Year C, Sub A created two wholly-owned domestic subsidiaries, Sub B and Sub C. Between Period B, Sub A transferred most of its partnership interests and its interests in the loans to Sub B and Sub C in return for stock. During Period A, Sub B created a wholly-owned domestic subsidiary, Sub D, to hold the partnership interests previously transferred by Sub A. For the taxable years Period C, Sub A, Sub B, Sub C, and Sub D filed consolidated U.S. federal income tax returns. On its Year D return, the Sub A, Sub B, Sub C, and Sub D consolidated group reported an Amount a NOL carryforward which was generated during the taxable years Period D.

Taxpayer represents that Amount b of the NOL was attributable to Sub A under the consolidated return rules.

Sub A liquidated on Date c. At the time of the liquidation, Sub A held only cash and its interests in Sub B and Sub C. Taxpayer represents that Sub A, Sub B, Sub C, and Sub D were U.S. real property holding corporations (USRPHC) under section 897(c)(2) at the time of liquidation and accordingly, Taxpayer's stock interest in Sub A was a U.S. real property interest (USRPI) under section 897(c)(1)(A)(ii) at that time. For this reason, taxpayer represents that Sub A was not required to recognize gain or loss on the liquidating distribution in Year D under Treas. Regs. §1.367(e)-2(b)(2)(ii) and (iii), and §1.897-5T(b)(3)(iv)(A). On the date of liquidation, Taxpayer represents that it had an adjusted basis in its Sub B stock of Amount c and of Amount d in its Sub C stock.

On Date d, Sub B and Sub C merged with Sub B as the surviving domestic entity. Sub B was renamed Sub E. Taxpayer represents that immediately after the merger Sub B and Sub C were USRPHCs and its stock in Sub B and Sub C were USRPIs. Taxpayer further represents that these companies remained USRPHCs at all times subsequent to the liquidation and that the later merged company, Sub E has also been a USRPHC at all times. Taxpayer represents that it had an adjusted basis in Sub E of Amount e. On Date e, Sub E made a distribution of Amount f to Taxpayer. Taxpayer represents that Amount g of the distribution was a dividend and Amount h was a return of capital. Taxpayer represents that its adjusted basis in Sub E was reduced to Amount i by the distribution.

On Date f, Sub E made a distribution of Amount j to Taxpayer. Taxpayer represents that Amount k of the distribution is a return of capital and Amount l is gain. Taxpayer represents that Sub E has no accumulated earnings and profits and has a projected loss for the Year A taxable year. Taxpayer represents that it intends to report the Amount l gain as U.S. effectively connected income pursuant to section 897(a). To date, Taxpayer has not utilized the Sub A NOL. Taxpayer represents that it continues to own the Sub E stock formerly owned by Sub A.

LAW and ANALYSIS:

Section 332(a) provides that no gain or loss shall be recognized on the receipt by a corporation of property distributed in complete liquidation of another corporation. Section 332(b)(1) and (2) provide in part that a distribution shall be considered in complete liquidation if (1) the corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock (in such other corporation) meeting the requirements of section 1504(a)(2) and if (2) the distribution is by such other corporation in complete cancellation or redemption of all its stock, and the transfer of all the property occurs within the taxable year. Taxpayer represents that it has met these requirements.

Section 381(a)(1) provides that in the case of the acquisition of assets of a corporation by another corporation in a distribution to which section 332 applies, the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution, various tax attributes of the distributing corporation as described in section 381(c), subject to various conditions and limitations. Section 381(c)(1) provides that subject to various conditions and limitations including requirements for the time of utilization and the amount, one such tax attribute is the distributing corporation's net operating loss carryovers determined under section 172. Taxpayer represents that it meets the conditions and limitations of section 381(c) with respect to the NOL received in the liquidation of its Sub A stock.

Section 882(a)(1) provides that a foreign corporation engaged in a trade or business within the United States during the taxable year shall be taxable as provided in section 11, 55, 59A, or 1201(a) on its taxable income which is effectively connected with the conduct of a trade or business in the United States.

Section 897(a)(1) generally provides that gain or loss from the disposition of a United States real property interest by a foreign corporation shall be taken into account under section 882(a)(1) as if the foreign corporation were engaged in a trade or business within the United States during the taxable year and as if the gain or loss were effectively connected with such trade or business. A United States real property interest includes an interest (other than an interest solely as a creditor) in any domestic corporation unless the taxpayer establishes that the corporation was at no time a United States real property holding corporation during the shorter of the period after June 18, 1980, during which the taxpayer held such interest or the five-year period ending on the date of disposition of the interest.

Section 301 provides rules regarding the distribution of property, as defined in section 317(a), made by a corporation to a shareholder with respect to its stock. Section 301(c)(1) provides that in the case of distributions to which section 301(a) applies, the portion of the distribution which is a dividend under section 316 shall be included in gross income. Section 301(c)(2) provides that the portion of the distribution which is not a dividend shall be applied against and shall reduce the adjusted basis of the stock. Section 301(c)(3)(A) provides that except as otherwise provided, the portion of the

distribution which is not a dividend shall be treated as gain from the sale or exchange of property. On Date g, Year A, Sub E made a distribution of which Taxpayer represents Amount I is treated as gain from the sale or exchange of property under section 301(c)(3)(A).

Section 882(c)(1) provides that in the case of a foreign corporation, deductions shall be allowed only for purposes of 882(a), except as otherwise provided, only if and to the extent that they are connected with income which is effectively connected with the conduct of a trade or business within the United States.

Under section 172(b)(1)(A), net operating losses carry back to each of the two taxable years preceding the taxable year of the loss and carry forward to each of the twenty taxable years following the taxable year of the loss.

Section 1.861-8(e)(8) provides that a net operating loss deduction allowed under section 172 shall be allocated and apportioned in the same manner as the deductions giving rise to the net operating loss deduction.

When Taxpayer received the interests in Sub B and Sub C from Sub A in the liquidating distribution in Year D, these interests were United States real property interests under section 897(c)(1)(A)(ii). These interests continued to be United States real property interests through Date g, Year A. Had Taxpayer disposed of its Sub B, Sub C, or later merged Sub E stock at any time after the liquidation of Sub A, the gain or loss from the dispositions would have been treated as income effectively connected with a trade or business of Taxpayer within the United States taxable under section 882(a).

Additionally, the Amount I distribution is effectively connected income pursuant to section 897(a).

Based solely on the facts and representations submitted, the NOL attributable to Sub A in Year D carries over to Taxpayer under section 381(a). Further, such NOL is treated as allocated and apportioned to Taxpayer's income effectively connected with Taxpayer's U.S. trade or business under section 1.861-8 in the year of liquidation and may be treated as a deduction against Taxpayer's effectively connected income during the period provided by section 172(b)(1)(A) subject to any applicable limitations. Accordingly, such NOL may be deducted against Taxpayer's effectively connected income including to the extent unutilized, the Amount I portion of the distribution from Sub E treated as gain in Year A.

No opinion is expressed as to whether the NOL would be apportioned under §1.861-8(e)(8) to Taxpayer's effectively connected income in Year A or any other year if the interests in the Sub B or Sub C stock were not United States real property interests at the time of the Sub A liquidation in Year D.

This letter is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

It is important that a copy of this letter be attached to the Federal income tax return of the taxpayers involved for the taxable year in which the determination covered by this letter is made.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the Taxpayer.

Sincerely,

Paul S. Epstein  
Senior Technical Advisor, Branch 5  
(International)